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IN THE

Supreme Court of the United States

OCTOBER TERM 1961

No. 711

AARON M. NADLER,
Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION
Respondent,

SECURITIES CORPORATION GENERAL,
Intervenor,

DYNAMICS CORPORATION OF AMERICA,
Intervenor,

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR INTERVENOR, SECURITIES CORPORATION GENERAL, IN OPPOSITION

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The Opinions Below

The opinion of the Court of Appeals (Petition, App. A, pp. 27 to 30) is reported at 296 F. 2d 63 (C.A. 2, 1961).

The Findings and Opinion of the Securities and Exchange Commission dated December 23, 1960 (Investment Company Act Release No. 3165) are unreported and are printed in petitioner's App. A at pp. 32 to 50.

The order of the Securities and Exchange Commission dated December 30, 1959 (Investment Company Act Release

No. 2958) is unreported and is printed in petitioner's App. A. at pp. 51 to 57.

Jurisdiction

The order of the Court of Appeals was entered on November 14, 1961. The petition for a writ of certiorari was filed on February 8, 1962. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1) and under 15 U.S.C. §80a-42(a).

Question Presented

Upon the application of Securities Corporation General ("SCG"), a registered investment company, the Securities and Exchange Commission ("Commission") entered an order exempting certain proposed transactions of SCG from the provisions of Sections 17(a) and 23(b) of the Investment Company Act of 1940 (the "Act"). Subsequently, it was discovered that the Board of Directors of SCG, at the time the application for exemption was made and the exemption was granted, was not constituted in accordance with Section 16(a) of the Act. The Commission thereupon instituted a proceeding to determine whether its exemption order should be revoked. After a lengthy hearing, the Commission concluded there was no basis for the revocation of the exemption order and that determination was affirmed by the court below.

Although the petition claims that several questions are presented, we believe that the only question raised by the petition is as follows:

Does the fact that the Board of Directors was not constituted in accordance with Section 16(a) make void, as a matter of law, the exemption order of the Commission, notwithstanding that the Board was properly constituted under state law, and notwithstanding that the Commission found that the exempted transactions were fair and reasonable and did not involve fraud or overreaching on the part of any one concerned?

The Statute Involved

Section 16(a) of the Investment Company Act of 1940 is set forth in Appendix B to the petition.

Statement of the Case*

SCG is a registered closed-end, non-diversified investment company, incorporated under the laws of the State of Virginia. Dynamics Corporation of America (DCA) is a corporation engaged in the manufacture of electronic and related products. Anemostat Corporation of America (Anemostat) is a corporation engaged in the manufacture of various equipment for air-conditioning systems.

Prior to October 1959, DCA controlled SCG through the ownership of the majority of the common stock of that company; it also owned the majority of SCG's preferred stock. In addition, DCA owned about 33% of Anemostat's common stock. At that time, the principal assets of SCG consisted of about 5% of DCA's common stock and 51% of Anemostat's common stock.

In order to eliminate the circular ownership outlined above and for other reasons, DCA sought to dispose of its holdings in SCG (R. 851, 1481, 1492) and also desired to acquire SCG's block of Anemostat common stock (R. 797-799).

Upon consulting legal counsel, DCA was advised that it could sell the SCG common stock owned by it to a limited number of persons, by means of a "private offering," without registration under the Securities Act of 1933. It was also advised that, after such a sale, it could negotiate with SCG for the purchase of the Anemostat stock owned by SCG. However, counsel stipulated that the offer to sell the

* Except where a different reference is noted, the facts set forth herein are those found by the Commission in its Findings and Opinion (Investment Company Act Release No. 3165) set forth at petitioner's App. A, pp. 32-50. "(R.)" refers to the record certified by the Commission to the Court of Appeals.

SCG stock could not be conditioned upon an understanding that the purchaser would thereafter cause the sale of the Anemostat stock to DCA (R. 797-799).

Acting upon this advice, DCA sold its holdings in SCG to five individuals and a corporation of which one of the individuals was general manager (R. 1479-83, 1484-86, 1487-89, 1492).

After completion of this sale, the six purchasers, who then owned a majority of the SCG common stock, requested that a director's meeting be called for the purpose of electing new officers and directors (R. 1525-1527). The SCG Board met on November 11, 1959, at which time the then incumbent directors resigned seriatim and elected three of the purchasers to fill their places. The new Board then appointed new officers. This election, although held in compliance with the laws of Virginia (Va. Code Ann. §13.1-38) and the by-laws of SCG, did not comply (except for the election of one of the three new directors) with Section 16(a) of the Act.

Reports of the election of the new directors and of the above sale were promptly filed with the Commission by DCA and the new directors.

At the same meeting, the new directors considered (and rejected) an offer made by DCA to exchange its holdings of SCG preferred stock plus accumulated dividends for the latter's Anemostat stock. Following negotiations, which were accelerated because of the impending expiration of substantial income tax loss carry-overs (R. 803-804), an agreement was reached, pursuant to which SCG agreed to sell to DCA all its common stock of Anemostat in exchange for all the preferred stock of SCG held by DCA plus approximately $156,000 in cash.*

At this point, the parties to the transaction learned for the first time that, contrary to the advice given earlier by

* This transaction was subsequently ratified at a regular meeting of the stockholders of SCG held on April 13, 1960. At that meeting, the same directors were re-elected for a further term.

DCA's counsel, it would be necessary to secure an exemption from the Commission under §§17(b) and 23(c) of the Act. Following an informal conference with the Commission staff, an application for such exemption was filed, and notice, as required by the Act, was given. On December 30, 1959, the Commission entered its order exempting the transaction and the transaction was consummated the following day. As required by the Act, the Commission expressly found that the sale of the Anemostat stock to DCA was consistent with the investment policy of SCG and with the general purposes of the Act and that "the terms of the proposed transaction including the consideration to be paid, are reasonable and fair and do not involve overreaching on the part of any person concerned."

Subsequently, the Commission, after an investigation initiated by petitioner's complaint, ordered a hearing to determine whether its order of exemption should be revoked because of the non-compliance with the requirements of Section 16(a) of the Act. Notice of that hearing was given to all shareholders of SCG. At that hearing, which dealt extensively with the fairness of the SCG-DCA transaction, some 1,300 pages of testimony were taken and some 90 documents were introduced. The hearing, in which petitioner participated, was followed by briefs and oral argument before the Commission itself. On the basis of that hearing and argument the Commission concluded:

> "We have found that the failure to comply with Section 16(a) was inadvertent; that since the purchasers of the SCG stock from DCA were the major beneficial owners of SCG they could have elected, and at the next regular meeting of stockholders did elect, their representatives as directors in compliance with the requirements of Section 16(a); that there is no evidence to show that there was fraud or overreaching in the Anemostat transaction or in the submission to us of the application for exemption; that we examined the proposal to sell the Anemostat stock before the

transaction was completed and issued an order in which we found, among other things, that the terms thereof, including the consideration to be paid, were reasonable and fair and did not involve overreaching on the part of any person concerned; and that following the issuance of our order and in accordance therewith the parties thereto consummated the transaction. Under all the circumstances we conclude that there is no basis for revoking our prior exemption order." (App. A, pp. 48-49).

Thereafter, petitioner filed a petition with the Court of Appeals for the Second Circuit to review the original order of the Commission and the Commission's refusal to revoke that order. On consent of all parties, DCA and SCG were granted leave to intervene. The Court below upheld the Commission's action.

Argument

A. Petitioner's ultimate objective is to set aside the sale of Anemostat stock by SCG to DCA, and the simultaneous purchase by SCG of its own preferred stock from DCA. These transactions were consummated pursuant to exemptions granted by the Commission under Sections 17(b) and 23(c) of the Act. In granting those exemptions, the Commission found that the transactions were "fair and reasonable and did not involve overreaching." That finding was reaffirmed by the Commission after a lengthy hearing and was upheld by the Court below. It may not be challenged here.

Petitioner challenges the transactions—and the Commission's exemption of the transactions—on the ground that the Board of Directors of SCG had not been elected in compliance with Section 16(a) of the Act, and that the actions of that Board are void. The question whether Section 16(a) of the Act makes void the transactions of the Corporation and the exemption by the Commission is the only

question presented by the petition. This question is, as petitioner claims, one of first impression. There is no conflict calling for resolution by this Court. Moreover, the decision below is in all respects correct.

The short answer to the contention of petitioner was given by the Court below:

> "We see no basis for the conclusion that all acts by a board not chosen as required by §16(a) must be considered void. The statute indicates that such a board has power to take action to secure a properly chosen board within a sixty-day period, which may be extended by the Commission. It would be an unsound policy, fraught with harm to the shareholders, to have everything done by such a board to carry on the corporation's normal business, especially within the statutory period, declared invalid. The Commission acted properly in carefully scrutinizing transactions during the interim period and in not voiding transactions found to be reasonable and proper in themselves."

This approach does not render Section 16(a) "meaningless and a dead letter" as petitioner argues (Petition, p. 10). The Commission has at its command a full arsenal of weapons to deal with Section 16(a) violations, including the power, if it sees fit, to revoke orders procured by persons not elected in compliance with its terms, to enjoin violations of the Act, and to proceed criminally against willful violators of the Act. As the Commission itself states:

> "This conclusion is not contrary to the provisions of Section 16(a) or of any other section of the Act, and it is consistent with the over-all purposes of the Act to serve the public interest and protect the interests of investors." * (Petition, App. A, pp. 42-43.)

* In addition, it has been held that the Commission has the authority to retroactively excuse a violation of the Act. *Hennessey* v. *SEC*, 285 F. 2d 511, (C.A. 3, 1961).

The interpretation by the Comimssion is entitled to great weight (*American Power and Light Company v. SEC*, 141 F. 2d 606, affirmed, 239 U.S. 90) and is determinative against petitioner's claim that the construction given Section 16(a) by the Court of Appeals defeats the purpose of that section and is contrary to the administrative interpretation thereof by the Commission.

It is clear, therefore, that no matter how viewed, the violation of Section 16(a) of the Act, at most, made the exemption subject to revocation and did not make such revocation mandatory. The determination to this effect by the Court of Appeals is correct.

B. Petitioner devotes approximately two-thirds of his brief (Points II and III) to arguing the proposition that a "public stockholder" has an independent right to seek a declaration that a transaction in violation of the Act is void, and that petitioner has been deprived of that right by the decision below. We simply do not understand this argument.

Petitioner, on April 1, 1960, commenced an action in the U. S. District Court for the Southern District of New York seeking to set aside the transaction between SCG and DCA. In that action, neither petitioner's power to bring the suit nor the jurisdiction of the District Court was ever questioned. Subsequently, as he admits (Petition, p. 9), petitioner entered into a stipulation providing for the dismissal of the District Court action if the order of the Commission, which is the subject of this petition, was finally sustained. It is that stipulation, voluntarily made by petitioner, rather than the decision of any court, which precludes the petitioner from prosecuting an independent action. Petitioner may now regret having entered into the stipulation, but we cannot see why this Court should entertain petitioner's collateral attack on his own stipulation.

So too, petitioner's desperate attempt to make capital of this Court's grant of certiorari in *Brouk v. Managed Funds, Inc.*, 286 F. 2d 901 (8th Cir.), cert. granted 366 U.S.

958, is completely devoid of merit. This case and the *Managed Funds* case both involve an interpretation of the Investment Company Act of 1940. Beyond that, the cases have nothing to do with each other. The question in the *Managed Funds* case (and in *Brown v. Bullock*, 294 F. 2d 415 [2nd Cir., 1961]) was whether the Act creates a federal cause of action by a stockholder, derivatively, or in his own right, to sue directors for alleged violations of the Act. The sole question there involved is whether, in the absence of diversity, the federal courts have jurisdiction over such a suit. The question of jurisdiction has never been raised in this case; petitioner had an opportunity in the federal court to try any issues he wished to try. However, he stipulated to waive that opportunity and to let his case stand or fall on the decision on the appeal from the Commission's order. That question was decided correctly below and there is nothing more for this Court to do.

Conclusion

For the reasons set forth above, it is respectfully submitted that the petition for a writ of certiorari should be denied.

Respectfully submitted,

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March 7, 1962